109th Congress
Preserving Credit Union Capital In Mergers

Background

Current law and FASB rules permit the recognition of the "retained earnings" of both the surviving and merged credit union after a merger. In 2004 there were 330 mergers involving federally insured credit unions (321 voluntary, 9 assisted). In 2003 there were 299 mergers (294 voluntary, 5 assisted).

The Financial Accounting Standards Board (FASB) is expected to act in 2005 to lift the current deferral of the acquisition method of accounting for mergers by credit unions. This will eliminate the practice of accounting for mergers as a pooling of interests which credit unions have relied upon.[1] When this change to accounting rules is implemented it will require, in a merger, that the retained earnings-like component of one credit union be carried over as "acquired equity," a term that is not recognized by the FCUA.

Without a change to the Federal Credit Union Act, only the "retained earnings" of the continuing credit union will count as net worth after the merger. This can seriously reduce the post-merger net worth ratio of combined federally insured credit unions. A lower net worth ratio has adverse implications under the statutory "prompt corrective action" provisions in the Federal Credit Union Act, and it is this result that will strongly discourage voluntary mergers and, on occasion, make NCUA assisted mergers more difficult and costly to the National Credit Union Share Insurance Fund (NCUSIF).

Legislative Status

U.S. House of Representatives

On March 2, 2005, Representative Spencer Bachus (R-AL) and Bernard Sanders (I-VT) introduced H.R. 1042, the "Net-Worth Amendment for Credit Unions Act." They were joined by the following original co-sponsors: Representatives Ed Royce (R-CA), Paul Kanjorski (D-PA), Steven LaTourette (R-OH), Luis Gutierrez (D-IL), Sue Kelly (R-NY), Carolyn Maloney (D-NY), Rick Renzi (R-AZ), Carolyn

[1] Statement of Financial Accounting Standard (SFAS) No. 141, Business Combinations, requiring the acquisition method for business combinations and effectively eliminating the pooling method. The pooling method has typically been used by credit unions to account for credit union mergers. The standards became effective for combinations initiated after June 30, 2001. Paragraph 60 of the standard deferred the effective date for mutual enterprises (i.e., credit unions) until the FASB could develop purchase method procedures for those combinations. In the interim, credit unions have continued to account for mergers as poolings (simple combination of financial statement components).

McCarthy (D-NY), Brad Sherman (D-CA), Bob Ney (R-OH), Tom Feeney (R-FL), Darlene Hooley (D-OR), Ginny Brown-Waite (R-FL).

NCUA Chairman JoAnn Johnson testified in favor of the legislation on April13, 2005 before the House Financial Institutions and Consumer Credit Subcommittee.

Why This Legislation Should Be Adopted

This amendment to the Federal Credit Union Act (FCUA) is needed to provide certainty for the recognition of pre-merger "retained earnings" as necessitated by FASB 141.

The FASB has expressed support for a legislative solution and has indicated that a legislative redefinition of capital (net worth) in the FCUA will not affect their standards-setting activities.

When crafting the prompt corrective action provisions of the FCUA in 1998 applicable to federally insured credit unions that only recognized "retained earnings" of a single credit union as net worth, the drafters did not anticipate this merger accounting policy change by FASB.

The consequence of not making this change will dramatically alter the treatment of retained earnings and net worth in a manner that will make it difficult or impossible for many credit unions to consider combining their strengths through merger. This seriously reduces the post-merger net worth ratio, because that ratio is the retained earnings stated as a percentage of the combined assets of the institutions. Potential acquiring credit unions would naturally find the prospect of being demoted to a lower net worth category, and potentially subject to more supervisory actions, too high a price to pay to merge with another credit union.

Failure to make this change will undermine the purpose of "prompt corrective action" which is to resolve the problems of credit unions while minimizing losses to the National Credit Union Administration Share Insurance Fund (NCUSIF). Fewer willing merger partners mean fewer opportunities to avert losses to the NCUSIF by merging a troubled credit union. Credit union mergers have traditionally been effective in accomplishing both objectives while preserving the continuity of credit union service to the target credit union's members.

NCUA recommends including regulatory authority comparable to other federal banking regulators to exclude items from pre-merger net worth that do not have value to the insurance fund in a liquidation scenario, e.g., core deposit intangibles, goodwill, etc., thus not "overvaluing" resulting post-merger capital.

Banks and their insurers do not have the same concerns because their existing capital definition under relevant law is broader. The FASB rule, in combination with their broader statutory definition of capital, would not result in similar problems for banks and thrifts because they are allowed to include virtually all components of “equity” in their capital.

H.R. 1042, titled “Net-Worth Amendment for Credit Unions Act” passed the House by voice vote on June 13, 2005.

Senate

Chairman Johnson called for the preservation of net worth of credit unions in mergers during her testimony before the Senate Committee on Banking, Housing, and Urban Affairs on June 21, 2005.

Updated: June 22, 2005